

Private Letter Ruling: Corporation designated a high impact business by the Department of Commerce and Community Affairs and which has some amount of payroll or property factor allocated to an enterprise zone qualifies to have its dividends subtracted in the computation of base income under IITA Section 203(a)(2)(J), (b)(2)(K), (c)(2)(O) or (d)(2)(M).

October 30, 2001

Dear:

This is in response to your letter dated October 18, 2001, in which you request a Private Letter Ruling (PLR) on behalf of xxxxxxxxxxxxxxxxxxxx ("xxxxxx") and xxxxxxxxxxxxxxxx ("Shareholder"). Review of your request for a PLR disclosed that all information described in paragraphs 1 through 8 of subsection (b) of 86 Ill. Adm. Code Section 1200.110 appears to be contained in your request. The PLR will bind the Department only with respect to xxxxxx and Shareholder for the issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that xxxxxx and Shareholder and/or any related taxpayer(s) is not currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

The facts and analysis as you have presented them are as follows:

## General Information

1. This request for a PLR is made on behalf of xxxxxx and Shareholder, Illinois taxpayers, and was prepared by the undersigned acting as the taxpayers' representative under powers of attorney, copies of which are attached hereto.
2. This PLR is not being requested based on hypothetical or alternative proposed transactions, but relates to the income tax consequences to Shareholder based on xxxxxxxx actual business practices.
3. This PLR request relates to tax years ending on and after xxxxxxxxxxxxxxxx. xxxxxx and Shareholder (and any related taxpayers) are unaware of any pending audits by the Department and are not involved in ongoing audits or litigation with respect to this tax issue.
4. There is no case law or regulation dispositive of the subject of this request.
5. Neither xxxxxx nor Shareholder previously submitted the same or a similar issue to the Department for a ruling, but withdrew the request prior to the issuance of such ruling. The Department has previously ruled on the same or a similar issue for xxxxxxxx xxxxxxxxxxxxxxxxxxxxxxxx, which ruling supports the PLR requested herein and is discussed below. xxxxxx and Shareholder know of no contrary authorities to the ones discussed herein.
6. xxxxxx and Shareholder request that the following information be deleted from the PLR prior to public dissemination: name and address of xxxxxx, Shareholder, the individuals carbon copied and the undersigned representative, the date of xxxxxxxx designation, the location of xxxxxxxx facilities and the names of its divisions, all numerical references

to numbers of employees, buildings, acres and dollars, and the reference in paragraph five above to "an entity affiliated with xxxxxx". For your convenience, we have enclosed a version of this ruling request with this information already deleted and can supply, at your request, an electronic version of the same.

## Facts

xxxxxx is a publicly-owned corporation that pays dividends to its shareholders, one of whom is an individual, xxxxxxxxxxxxxxxx, referred to herein as Shareholder.

xxxxxx was designated an Illinois High Impact Business ("HIB") by the Illinois Department of Commerce and Community Affairs ("DCCA"), a copy of which designation is attached. The date of the designation is xxxxxxxxxxxxxx and the designation is for a period not to exceed xxxxxx years. The HIB designation applies to xxxxxxxx large scale investment and development projects in xxxxxxxxxxxxxx and xxxx xxxxxx, Illinois. xxxxxxxxxxxxxx is located in a Foreign Trade Sub-Zone.

xxxxxx conducts numerous business operations in xxxxxxxxxxxx, which is located in a federally designated Foreign Trade Sub-Zone. xxxxxx employs approximately xxxxxx full-time employees at the xxxxxxxxxxxx complex, which encompasses approximately xx buildings spread over approximately xxxxx acres. xxxxxxxxxxxxxxxxxxxxxxx facilities are not located within an Illinois Enterprise Zone; nor does xxxxxx conduct substantially all its operations in an Illinois Enterprise Zone or zones.

## Research and Development Activities at xxxxxxxxxxxx

xxxxxx conducts substantial research and development ("R&D") activities at the xxxxxx  
xxxx location. Approximately xxxxx full-time employees are involved in R&D activities at  
xxxxxxxxxxx, which R&D activities span xxxxx buildings at the xxxxxxxxxxxx complex.  
Most of the R&D for xx, xxxxxxxxxxxxxxxxxxxx  
xxxxxxxx and xxxxxxxxxxxxxxxxxxxxxxx takes place at xxxxxxxxxxx within the Foreign  
Trade Sub-Zone. Additional R&D activities on behalf of other related entities also take  
place at xxxxxxxxxxxxxxxxxxx location. xxxxxx annually spends in excess of \$xxx  
xxxxxxx on R&D at xxxxxxxxxxx.

## Manufacturing and Packaging Activities at xxxxxxxxxxxx

Approximately xxxxx full-time employees spread over xxxxxx buildings at the xxxxxx  
xxxx complex are involved in manufacturing activities within the Foreign Trade Sub-  
Zone. Substantial manufacturing takes place at xxxxxxxxxx on behalf of xxxxxxxx  
xxxxxxxxxxxxxxxxxxxxxxx, and xx as well as on behalf of  
other related entities.

## Distribution Center at xxxxxxxxxxxx

xxxxxx employs approximately xxx full-time employees who handle all distribution activities for xxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxx and substantial distribution on behalf of xxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxx and other related entities at xxxxxxxxxxxx. xxxxxxxx group responsible for distribution throughout the country is also housed at the

distribution center at xxxxxxxxxx. In addition to xxxx non-regulated distribution facilities at xxxxxxxxxx, a xxxxx, controlled warehouse containing certain regulated xxxxxxxxxxxxxxxx is in the xxxxxxxxxx complex within the Foreign Trade Sub-Zone.

### **Selling, General and Administrative Activities**

xxxxxxxxxxxxxxxxxxxxxxxxxxxx, xxxxxxxxxxxxxxxxxxxxxxxx, xxxxxxxxxxxxxxxx xxxxxxxxxxxx are headquartered at xxxxxxxxxx within the Foreign Trade Sub-Zone. The remaining full-time employees are involved in providing selling, general and administrative services out of xxxxxxxxxxxx locations. These activities include executive, accounting, management information services, administrative, engineering, quality control, training, tax, payroll, legal, marketing, promotion, and telecommunications.

### **Authorities**

The Illinois Income Tax Act ("IITA") defines base income of an individual or a corporation as the taxpayer's taxable income for the taxable year as modified. IITA §§203(a)(1), 203(b)(1). One subtraction modification to arrive at base income is codified in IITA §203(a)(2)(K) (for individuals) and §203(b)(2)(L) (for corporations) and reads as follows:

An amount equal to those dividends included in such total that were paid by a corporation that conducts business operations in a federally designated Foreign Trade Zone or Sub-Zone and that is designated a High Impact Business located in Illinois, provided that dividends eligible for the deduction provided in subparagraph (J) [or (K)] of paragraph 2 of this subsection shall not be eligible for the deduction provided under this subparagraph (K) [or (L)].

The above statute provides an exception to the HIB dividend subtraction modification for dividends eligible for deduction under IITA §203(a)(2)(J) (for individuals) and IITA §203(b)(2)(K) (for corporations). IITA §203(a)(2)(J) and IITA §203(b)(2)(K) provide a subtraction modification for dividends that were paid by a corporation conducting substantially all of its business operations in an Illinois Enterprise Zone. Therefore, dividends paid by a corporation that meets both the Enterprise Zone requirements and the HIB operating in a Foreign Trade Zone requirements may only be subtracted under the Enterprise Zone statute.

### **Business Operations in a Foreign Trade Sub-Zone**

The statute does not contain any language specifying the level of operations to be conducted in the Foreign Trade Zone or Sub-Zone. Nor has the Department promulgated a regulation discussing the required level of operations to be conducted within a Foreign Trade Zone or Sub-Zone. The Department has not published any General Information Letters or Administrative Hearings addressing this topic; nor has the issue arisen in any published Illinois court case.

The Department has issued one private letter ruling on this topic of the level of operations needed to be conducted in the Foreign Trade Zone or Sub-Zone. In Private

Letter Ruling IT-01-\_\_\_\_ (Aug. 2, 2001), the Department concluded that dividends paid by an HIB corporation qualify for the subtraction modification under IITA §203(b)(2)(L) provided that the corporation conducts any business operations in a federally designated Foreign Trade Zone or Sub-Zone, so long as the dividends are not eligible for the subtraction modification under IITA §203(b)(2)(K). In the ruling, the Department analyzed its Regulation section 100.2480 concerning dividends paid by a corporation that conducts substantially all its business operations in an Illinois Enterprise Zone, which regulation relates to IITA §203(b)(2)(K). Because of the similarity of that statutory section to IITA §203(b)(2)(L), the Department concluded that this regulation would be applied, with several modifications, to determine whether business activity in a Foreign Trade Zone or Sub-Zone satisfied the requirements of IITA §203(b)(2)(L).

According to the Department,

[C]onsistent with section 203(b)(2)(L), then, Regulations section 100.2480 shall be applied with the following modifications. First, the corporation must be designated a High Impact Business located in Illinois. Second, the corporation must conduct business operations in a federally designated Foreign Trade Zone or Sub-Zone. Third, because section 203(b)(2)(L) requires merely that business operations be conducted in a federally designated Foreign Trade Zone or Sub-Zone, rather than “substantially all” of such operations as required under section 203(b)(2)(K), Regulation sections 100.2480(b) shall be applied by substituting the term “greater than 0%” in place of the term “95% or more”. Finally, dividends paid by such corporation must not be eligible for the subtraction modification provided by IITA section 203(b)(2)(K).

xxxxxx clearly satisfies the threshold requirement of conducting business operations within a Foreign Trade Zone or Sub-Zone. xxxxxx conducts substantial R&D, manufacturing, packaging and distribution activities in a Foreign Trade Sub-Zone. In addition, many other general and administrative services are performed by xxxxxx in a Foreign Trade Sub-Zone. These activities located in a Foreign Trade Sub-Zone comprise a vital part of xxxxxxxx business operations. xxxxxx therefore meets the requirements for the dividend subtraction modification that the corporation paying the dividend is conducting business operations in a Foreign Trade Sub-Zone.

xxxxxx has, therefore, concluded that the dividends paid to its shareholders would qualify for the subtraction modification codified in IITA §203(a)(2)(K) (for individuals) and IITA §203(b)(2)(L) since xxxxxx is designated a HIB and is conducting vital business operations in a Foreign Trade Sub-Zone.

### **Rulings Requested**

1. xxxxxx respectfully requests a ruling from the Department confirming that all of xxxxxxxx dividends paid to its shareholders qualify for the subtraction modification codified in IITA §203(a)(2)(K) (related to dividends received by individual shareholders) and IITA §203(b)(2)(L) (related to dividends received by corporate shareholders) as dividends paid by a corporation that conducts business operations in a federally designated Foreign Trade Sub-Zone and that is designated a High Impact Business located in Illinois.
2. Shareholder is eligible for the subtraction modification provided in IITA §203(a)(2)(L) for dividends paid on or after June 15, 2001.

### **RULING**

#### **Applicable Law**

With respect to individuals, corporations, and trusts and estates, sections 203(a)(2)(J), 203(b)(2)(K), and 203(c)(2)(M) of the Illinois Income Tax Act ("the IITA"; 35 ILCS 5/101 *et seq.*) provide, respectively, the following subtraction modification in the computation of base income:

An amount equal to those dividends included in such total which were paid by a corporation which conducts business operations in an Enterprise Zone or zones created under the Illinois Enterprise Zone Act and conducts substantially all of its operations in an Enterprise Zone or zones[.]

Department of Revenue Regulations section 100.2480(b) establishes the test to determine whether a corporation conducts "substantially all" of its operations in an Enterprise Zone or zones, as follows:

A corporation conducts substantially all of its business within an Enterprise Zone when 95% or more of its total business activity during a taxable year is operated within an Enterprise Zone. For the purpose of this Section, business activity within an Enterprise Zone shall be measured by means of the factors ordinarily applicable to the corporation under subsection (a), (b), (c), or (d) of IITA Section 304 except that, in the case of a corporation ordinarily required to apportion business income by means of the 3-factor formula of property, payroll and sales specified in subsection (a) of Section 304, such corporation shall not use the sales factor in the computation. In measuring the business activity of a corporation within an Enterprise Zone, the apportionment factors of that corporation shall be determined without regard to the factors or business activity of any other corporation and, in the case of a corporation engaged in a unitary business with any other person, the apportionment factors of that corporation shall be determined as if it were not engaged in a unitary business with such other person.

Regarding a corporation ordinarily required to apportion business income by means of the three-factor formula of IITA section 304(a), section 100.2480(b)(1) continues as follows:

3-Factor Corporations. A corporation using property, payroll and sales to apportion business income to Illinois under subsection (a) of Section 304 shall compare the corporation's property

and payroll within an Enterprise Zone to the corporation's property and payroll everywhere. The result of the property and payroll factor computations shall be divided by 2 (by one if either the property or payroll factor has a denominator of zero). If the amount so computed is 95% or greater, the dividends paid by the corporation shall qualify for this subtraction. In the case where a corporation does not have any payroll or property within an Enterprise Zone, the corporation is not conducting any of its business operations within an Enterprise Zone for the purpose of this Section.

IITA section 203(b)(2)(L) provides corporations a similar subtraction modification as that allowed under section 203(b)(2)(K). Section 203(b)(2)(L) states:

An amount equal to those dividends included in such total that were paid by a corporation that conducts business operations in a federally designated Foreign Trade Zone or Sub-Zone and that is designated a High Impact Business located in Illinois; provided that dividends eligible for the deduction provided in subparagraph (K) of paragraph (2) of this section [regarding dividends paid by a corporation conducting substantially all of its operations in an Illinois Enterprise Zone or zones] shall not be eligible for the deduction provided under this subparagraph (L)[.]

IITA section 203(a)(2)(K) provides individuals this same subtraction modification provided corporations.

Although regulations have not been promulgated under IITA sections 203(b)(2)(L) or 203(a)(2)(K), the provisions are similar to the subtraction modification allowed under section 203(b)(2)(K). Thus, to the extent not inconsistent with the language of sections 203(b)(2)(L) or 203(a)(2)(K), the subtraction modification provided by those sections shall be applied according to the rules at Regulations section 100.2480. Consistent with sections 203(b)(2)(L) and 203(a)(2)(K), then, Regulations section 100.2480 shall be applied with the following modifications. First, the corporation must be designated a High Impact Business located in Illinois. Second, the corporation must conduct business operations in a federally designated Foreign Trade Zone or Sub-Zone. Third, because sections 203(b)(2)(L) and 203(b)(2)(K) require merely that business operations be conducted in a federally designated Foreign Trade Zone or Sub-Zone, rather than "substantially all" of such operations as required under section 203(b)(2)(K), Regulations section 100.2480(b) shall be applied by substituting the term "greater than 0%" in place of the term "95% or more." Finally, dividends paid must not be eligible for the subtraction modification provided for dividends paid by a corporation that conducts substantially all of its activities in an Illinois Enterprise Zone.

Accordingly, a corporation designated a High Impact Business in Illinois and that apportions business income to Illinois under subsection (a) of IITA section 304 must compare its property and payroll within a federally designated Foreign Trade Zone or Sub-Zone to the corporation's property and payroll everywhere. If the amount so computed is greater than 0%, and the dividends paid are not eligible for the subtraction modification for dividends paid by a corporation that conducts substantially all of its activities in an Illinois Enterprise Zone, the dividends paid by the corporation will qualify for the subtraction modification provided by sections 203(b)(2)(L) and 203(a)(2)(K).

## **Analysis**

In the instant case, you have indicated that xxxxxx has been designated a High Impact Business located in Illinois effective June 15, 2001. In addition, you indicate that xxxxxx does not conduct

substantially all of its business activities in an Illinois Enterprise Zone. Therefore, dividends paid by xxxxxx will qualify for the subtraction modification under sections 203(b)(2)(L) and 203(a)(2)(K) provided that it conducts business operations in a federally designated Foreign Trade Zone or Sub-Zone.

You have indicated that certain xxxxxx employees work full-time at xxxxxx facilities located in a federally designated Foreign Trade Sub-Zone. Therefore, xxxxxx has property and payroll in the numerator of the federally designated Foreign Trade Zone or Sub-Zone apportionment factor, resulting in a factor greater than 0%. Accordingly, xxxxxx conducts business operations in a federally designated Foreign Trade Zone or Sub-Zone.

### **Conclusion**

In accordance with the above analysis, dividends paid by xxxxxx on or after June 15, 2001 are eligible for the subtraction modification under IITA sections 203(b)(2)(L) and 203(a)(2)(K). Shareholder will be allowed the subtraction modification under IITA section 203(a)(2)(K) for distributions from xxxxxx otherwise eligible under the rules of Regulations section 100.2480.

The facts upon which this ruling is based are subject to review by the Department during the course of any audit, investigation, or hearing. This ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

Very Truly Yours,

Brian L. Stocker

Staff Attorney (Income Tax)